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In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

AMERICAN COLLEGE OF PHYSICIANS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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In our opening brief, we contend that this case is governed by Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7), which Congress explicitly endorsed in 1969. That Example concerns a tax-exempt professional association which, like respondent, has among its goals the "continuing education of its members in matters pertaining to their profession" (*ibid.*). The Example addresses the publication by such an association in its professional journal of advertising which, like respondent's advertising, "promotes only products which are within the general area of professional

interest of its members" (*ibid.*). The Example concludes that the association's "publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute" (*ibid.*). Such commercial publicity, the Example observes, "differs fundamentally from [an educational] activity both in its governing objective and in its method," since "the form, content, and manner of presentation of the advertising messages are governed by the basic objective of the advertisers to promote the sale of the advertised products" (*ibid.*). The Example accordingly concludes that the publication of commercial advertising does not "contribute importantly" to the accomplishment of the association's educational purposes and that its advertising revenues are subject to tax (*ibid.*).

In contending that *its* publication of commercial advertising *does* contribute importantly to the accomplishment of *its* educational purposes, and that its advertising revenues should be immune from tax, respondent seeks to avoid Example 7 in three ways. First, it contends that its advertisements are "uniquely informative" (Br. 35) and "materially different" (*id.* at 42) from the advertisements in Example 7. Second, it contends (*id.* at 35-42) that Example 7 does not apply to it. Third, it contends (*id.* at 44-46) that the Regulation is invalid. We anticipated each of these contentions in our opening brief and have shown each to be wrong. Several of respondent's assertions, however, warrant a brief reply.

1. In asserting that its advertisements are "materially different" (Br. 42) from those described in Example 7, respondent relies principally on what it

calls "the pervasive regulation of the content and format of prescription drug ads" by the Food and Drug Administration (Br. 3, 43 n.51, 43-44 n.53). As a result of FDA rules "specifying the required and prohibited editorial content of prescription drug ads," respondent says, the "content and design of [such] ads is largely mandated by the government" (*id.* at 3, 44 n.53). Compliance with FDA regulations assertedly makes respondent's ads "uniquely informative" (*id.* at 35), so that "in substantial part [they] serve not the private commercial purposes of the advertiser, but rather a public purpose" (*id.* at 43 n.51). Respondent thus concludes that its advertising, unlike that in Example 7, is not "designed and selected in the manner of ordinary commercial advertising" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)).

The FDA's rules governing prescription drug advertising have their genesis in the Federal Food, Drug, and Cosmetic Act, ch. 675, 52 Stat. 1040 *et seq.* As amended by the Drug Amendments of 1962, Pub. L. No. 87-781, § 131, 76 Stat. 791-792, the Act requires inter alia that manufacturers include in their advertisements for prescription drugs a "brief summary" describing the product's "side effects, contraindications, and effectiveness" (21 U.S.C. 331, 352(n)). Under FDA regulations, this summary must be "true" and must "present a fair balance" concerning "the selected purpose(s) for which the drug is recommended or suggested in the advertisement" (21 C.F.R. 202.1(e)(3)(ii)). So-called "reminder advertisements," which merely "call attention to the name of the drug product" without including indications or dosage recommendations for its use, are exempt from these rules (21 C.F.R. 202.1(e)(2)(i)).

There is no merit whatsoever to respondent's assertion that, in consequence of these FDA regulations, the "content," "design," and "format" of its drug advertisements are "largely mandated by the government" (Br. 3, 43 n.51, 43-44 n.53). While the FDA sets forth general guidelines designed to prevent drug ads from being false or misleading, the basic decisions about what will be said in each ad, and how it will be said, remain the province of the advertisers, who enlist the considerable literary and promotional skills of Madison Avenue in an effort to sell their wares. The FDA does not require that respondent's ads depict happy faces beaming down on bottles of Robitussin (Pet. App. 56a), project full-page illustrations of the Great Wall of China to promote angina medication (*id.* at 66a), or show shapely calves, well-stockinged in support hose, in close proximity to footballs (*id.* at 62a). The FDA rules in some instances may require that respondent's ads, like those described in Example 7, provide certain information in order 'to comply with * * * general standards of taste, fairness, and accuracy" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)). "[B]ut within those limits the form, content, and manner of presentation of [respondent's] advertising messages," as of the advertising messages described in Example 7, "are governed by the basic objective of the advertisers to promote the sale of the advertised products" (*ibid.*). Cigarette advertisements, like prescription drug advertisements, are subject to "pervasive regulation" (Resp. Br. 43 n.53) by the government. See 15 U.S.C. 1331 *et seq.* But it could scarcely be contended that scenes of cowboys riding into the sunset are "uniquely informative" (Resp. Br. 35) or "materially different" from other commercial advertising messages (*id.* at

42) by virtue of including the Surgeon General's warning. See 15 U.S.C. 1333.

In seizing upon the FDA regulations to differentiate drug ads from the common run of taxable commercial advertising, respondent and amici reiterate in this Court arguments that they unsuccessfully made to Congress in 1969. See, *e.g.*, *Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess. 1114, 1119, 1200, 1260-1261, 1391. The American Medical Association, amicus here, emphasized before Congress what "[t]he food and drug law requires" of prescription drug ads in an effort to demonstrate that "[n]o other advertising provides as much complete and objective information" (*id.* at 1261). The American Psychiatric Association told Congress that it should "be thankful that we have such informative drug advertisements, regulated as they are by the Food and Drug Administration" (*id.* at 1119). And respondent itself testified that the ads in its journal provide a "thumbnail sketch of what [a prescription] drug does, what its contraindications are, what its precautions are, what its warnings are," all "according to Food and Drug Regulations" (*id.* at 1114). Unpersuaded by their testimony, Congress expressly approved the challenged regulations, noting that they "mainly affected the advertising income of publications such as medical journals," the bulk of whose advertisements, then as now, promoted prescription drugs. H.R. Rep. 91-413, 91st Cong., 1st Sess. Pt. 1, at 44 (1969).

Respondent's effort to differentiate its ads from those in Example 7 is thus unavailing. The FDA regulations obviously do not distinguish respondent's drug ads from those appearing in taxpaying medical journals—many of whose ads "were identical" to re-

spondent's (Pet. App. 28a)—since those regulations, applicable as they are to all prescription drugs in interstate commerce (21 U.S.C. 331), cover drug advertising nationwide. And the FDA regulations do not distinguish respondent's ads from those described in Example 7, since those ads likewise couple a predominately commercial message with certain information designed to ensure compliance with "general standards of taste, fairness, and accuracy." The Claims Court's findings of fact, encapsulated in its determination that respondent's advertising "was typical commercial publicity" (Pet. App. 28a), show that respondent's ads, like those in Example 7, were "designed and selected in the manner of ordinary commercial advertising." See U.S. Br. 30-31. Example 7 accordingly dictates that respondent's advertising profits are subject to tax.[1]

2. Respondent alternatively contends (Br. 18-20, 35-42) that, if its advertising should be deemed to resemble that in Example 7, the principles of Example 7 should not apply to it, tax-exempt as it is under Section 501(c)(3), but rather should apply only to advertising published by professional associations that are tax-exempt as "business leagues" under Section

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[1] Amicus curiae American Society of Association Executives (Br. 19-26) supports respondent's contention that its commercial advertising, notwithstanding Example 7, should be deemed "substantially related" to its educational purposes. The counsel of record for that association, however, took a rather different view of the Regulation in 1969. "[I]t is arguable," he wrote following the enactment of Section 513(c), "that there can still be 'related' advertising. However, the legislative history and intent of the Congress is so clear that the likelihood of this argument prevailing as to any period after December 31, 1969 is very improbable." Webster, *Unrelated Business Income*, 23 Tax Law. 471, 476 (1969).

501(c)(6). But as we showed in our opening brief (at 34-40), the subsection of Section 501(c) under which a tax-exempt publisher happens to be organized makes no difference in determining the educational character of the advertising that it publishes. Example 7 concludes that ordinary commercial advertising like respondent's is not "educational" in the sense intended by the tax-exemption statute because its "informational function is incidental to the controlling aim of stimulating demand for the advertised products" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)). Obviously, that conclusion logically applies regardless of the source of the publisher's tax exemption: it is the educational character vel non of the *advertising* that determines the application of the unrelated business income tax.

We further explained in our opening brief (at 35, 38-39) that Example 7 could not sensibly be read as respondent would read it, since professional associations like respondent generally have the option of qualifying for tax exemption *either* under Section 501(c)(3) *or* under Section 501(c)(6). Respondent professes to find this "[o]ne of the more surprising aspects" of our brief, contending that "[t]he (c)(3) category of exemption is distinguishable from (c)(6) in several * * * significant respects" (Br. 37, 39). We of course agree that there may be significant differences *at the margins* between some Section 501(c)(3) groups (such as churches) and some Section 501(c)(6) groups (such as professional football leagues). Our point was rather that any such differences are generally slight *in the case of professional associations like respondent*—organizations that draw their membership exclusively from a single profession and that have broad educational or charitable goals (U.S. Br. 35, 38).

Respondent studiously avoids controverting the point that we actually made (see Resp. Br. 42), and the briefs filed by amici curiae herein demonstrate that our point is correct. Amicus Massachusetts Medical Society recites that it is "the oldest American medical association in continuous existence," that its principal purposes include the promotion of health care and the "conduct of educational programs," and that it publishes "journals and periodicals * * * devoted primarily to the science and practice of medicine." Brief for the American Medical Association and the Massachusetts Medical Society as Amici Curiae at 2. Amicus American Medical Association recites that it "was founded in 1846 to promote the science and art of medicine and the betterment of public health" and that it "publishes scholarly medical journals in furtherance of its exempt purposes" (*id.* at 1-2). These two associations recite exempt purposes virtually identical to respondent's (see Resp. Br. 2), yet both are tax-exempt under Section 501(c)(6) rather than under Section 501(c)(3).

There is thus no merit to respondent's assertion that the reference in Examples 6 and 7 to "an association exempt under Section 501(c)(6)" reflects a deliberate decision on the Treasury's part (Resp. Br. 36) to confine those Exemples' analysis to publishers that rely on Section 501(c)(6) as the source of their exemption. The principles of Examples 6 and 7 have been universally understood—by Congress, the courts, the Internal Revenue Service, scholarly commentators, and witnesses (including respondent itself) who testified concerning the Regulation before Congress in 1969—to apply to tax-exempt publishers across the board. See U.S. Br. 36-38; Rev. Rul. 72-431, 1972-2 C.B. 281 (applying principles of Example 7 to Section

501(c)(3) group); *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 484 n.19 (1979) ("While the plausibility and consistency of the Commissioner's interpretation are relevant to the reasonableness of the regulation as applied * * *, the Commissioner is otherwise free to determine how the regulation he has written should be construed."). Examples 6 and 7, like the thousands of other examples incorporated in the Treasury Regulations, are meant to be concrete illustrations of general rules. If they were not particularized, they would not be "examples." To deprive their analysis of any extrapolative force, as respondent would do, is to ignore their function.[2]

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[2] As respondent itself observes (Br. 36 & App. A), the regulations promulgated under the Code's unrelated business income tax provisions include more than 80 examples, and these examples refer to their various tax-exempt subjects in various ways. They sometimes refer generically to "an exempt organization" (Treas. Reg. § 1.512(b)-1(c)(2)(iv) (Example)); they sometimes refer to an organization by its category, *e.g.*, a "scientific organization" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 1)); they sometimes refer to an organization by the subsection under which it is exempt, *e.g.*, "an organization described in section 501(c)(3)" (Treas. Reg. § 1.513-1(d)(4)(i) (Example 1)); and they sometimes refer to an organization by a combination of the latter two methods, *e.g.*, "an exempt scientific organization described in Section 501(c)(3)" (Treas. Reg. § 1.512(b)-1(*l*)(2)(ii) (Example 1)). Examples using business leagues as their subjects reveal the same heterogeneous pattern, referring sometimes to "an exempt business league" (Treas. Reg. § 1.512(a)-1(e) (Example)), sometimes to "an exempt trade association" (Treas. Reg. § 1.512(a)-1(f)(2)(iii) (Example 1)), sometimes to "an association exempt under section 501(c)(6)" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 6)), sometimes to "an organization described in section 501(c)(6)" (Treas. Reg. § 1.513-3(e) (Example 1)), and sometimes to "an exempt trade association described in section 501(c)(6)" (Treas.

3. Respondent finally asserts that Example 7, if construed to reach its advertising, "lacks a rational basis" and "must be overturned [as] in conflict with the statute or otherwise in excess of legislative authority" (Br. 45-46). Respondent understandably proffers this contention hesitantly, since, as we showed in our opening brief (at 18-26), Congress explicitly endorsed the Regulation in 1969. But respondent professes to find that legislative history "contradictory," "scattered," "sketchy and generalized," and as hard to "divine" as "tea leaves" (Br. 21, 25, 27, 33). Noting that the Tax Reform Act of 1969 did not change the statutory definition of "unrelated trade or business" (I.R.C. § 513(a)), respondent argues that "the 1969 legislative history * * * is of little value" in resolving the question presented here (Br. 11). And even if Congress in 1969 should be thought to have endorsed the Regulation "in general," respondent says, Congress surely cannot be held to have approved the Regulation's every jot and tittle, least of all something as lowly as a mere "Example" (Resp. Br. 26 n.31, 29, 34). Respondent notes that the House bill was 368 pages long, and suggests that Examples 6 and 7 may have crept by while Congress, distracted by weightier matters, was looking in the other direction (Resp. Br. 21).

These contentions are wholly insubstantial. To begin with, it is well established that interpretive

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Reg. § 1.514(b)-1(c)(2)(ii) (Example 1)). The randomness of this pattern confirms the common sense observation that the Regulations in their various examples use various types of exempt organizations for illustrative purposes only, and that no weight should be attached to the particular subject used or to the particular formula used to describe it.

regulations of the Treasury, "if found to 'implement the congressional mandate in some reasonable manner,' must be upheld." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. at 476 (quoting *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973)). The conclusion reached by Example 7—that commercial advertising "differs fundamentally from [an educational] activity both in its governing objective and in its method"—is a logical construction of the term "educational" as used in Section 501(c)(3). As noted in our opening brief (at 43), to the extent a publisher uses commercial advertising as an information-conveying vehicle, charging the advertiser a fee as a condition to publishing the ad, the message is one of the advertiser rather than one to which the publisher would choose to devote its own, general resources. From the publisher's perspective, therefore, any "informational function" of such advertising is, as the Claims Court found, "incidental to its purpose of raising revenue" (Pet. App. 30a). From the advertiser's perspective, similarly, the ads' informational content is just one means of furthering "the controlling aim of stimulating demand for the advertised products" (Treas. Reg. § 1.513-1(d)(4)(iv) (Example 7)). Respondent's publication of commercial advertisements, like other commercially-oriented ventures, may, as this Court has observed, "serve incidentally to educate certain persons. But [it is] directed fundamentally to ends other than that of education." *Better Business Bureau* v. *United States*, 326 U.S. 279, 284 (1945). In reaching the same conclusion in Example 7, the Treasury acted well within the scope of its interpretive authority.

Contrary to respondent's contention, moreover, Example 7 has received the explicit endorsement of Congress, and it thus carries with it a particularly

strong, if not an irrebuttable, presumption of correctness. After the Regulation was promulgated, Congress held extensive hearings specifically to consider "whether advertising income should be characterized as unrelated in the case of magazines and other periodicals published by exempt organizations where the editorial matter of the publication is related to its exempt function." *Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess. 6 (1969). After listening for several days to arguments substantially similar to those respondent and amici voice here, Congress enacted Section 513(c) of the Code, entitled "Advertising, Etc., Activities." In the course of doing so, Congress expressly endorsed the challenged Regulation, noting that it "mainly affected the advertising income of publications such as medical journals" (H.R. Rep. 91-413, 91st Cong., 1st Sess. Pt. 1, at 44 (1969)). The House stated that, under the statutory standard it was then adopting, "advertising in a journal published by an exempt organization is not related to the organization's exempt functions, and therefore * * * this income should be taxed" (*id.* at 50). The Senate agreed that the Regulations, "insofar as they apply to advertising and related activities, should be placed in the tax laws" (S. Rep. 91-552, 91st Cong., 1st Sess. 75 (1969)). And Examples 6 and 7, contrary to respondent's assertion, were not at the periphery of what Congress endorsed, but were at its core, for it was those Examples that discussed the tax treatment of professional journal advertising, upon which the bulk of the controversy centered.

This Court has repeatedly held that " 'the construction of a statute by those charged with its execution should be followed unless there are compelling indica-

tions that it is wrong, especially when Congress has refused to alter the administrative construction.'" *CBS, Inc.* v. *FCC*, 453 U.S. 367, 382 (1981) (quoting *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969)). Accord, *e.g.*, *Haig* v. *Agee*, 453 U.S. 280, 291 (1981). Here, moreover, by amending Section 513(c) in 1969 to pave the way for the Regulation's enforcement, "Congress has not just kept its silence by refusing to overturn the administrative construction but has ratified it with positive legislation." *Red Lion Broadcasting Co.*, 395 U.S. at 381-382. There is accordingly no basis for respondent's challenge to the validity of the Regulation.

CONCLUSION

For these reasons and for the reasons set forth in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

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